

City of Detroit

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## OFFICE OF THE AUDITOR GENERAL



**Audit of Contracts  
Less Than \$25,000  
March 2006**



Loren E. Monroe, CPA  
Auditor General  
City of Detroit

Office of the Auditor General  
2 Woodward Ave, Room 208  
Detroit, Michigan 48226  
Phone 313.224-3101  
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## MEMORANDUM

**DATE:** June 5, 2006

**TO:** Roger Short  
Interim Chief Financial Officer

**FROM:** Loren E. Monroe *Loren E Monroe*  
Auditor General

**RE:** Audit of Contracts Less Than \$25,000

**C:** Honorable City Council  
Mayor Kwame M. Kilpatrick  
James J. Tyler Jr., Human Resources Department

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Attached for your review is our report on the Audit of Contracts Less Than \$25,000. This report contains our audit purpose, scope, objectives, and methodology; our findings and recommendations; and the agencies' response.

We would like to thank the Finance and Human Resources Departments for the cooperation and assistance extended to us during this audit.

Copies of all of the Office of the Auditor General reports can be found on our website at [www.ci.detroit.mi.us/legislature/CharterAppointments/AuditorGeneral](http://www.ci.detroit.mi.us/legislature/CharterAppointments/AuditorGeneral).

# **Audit of Contracts Less Than \$25,000**

**March 2006**

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## **AUDIT PURPOSE, SCOPE, OBJECTIVES, AND METHODOLOGY**

### **Audit Purpose**

The audit of contracts less than \$25,000 was performed under the Office of the Auditor General's (OAG) Charter mandate to audit financial transactions of all City agencies. The OAG initiated this audit to determine whether contract purchase orders were created when payments were estimated to be \$25,000 or more for services, and whether established City procedures were followed.

### **Audit Scope**

The scope of this audit was limited to a review of payments made to professional service contractors between January, 2005 and February, 2006 for accounting related services provided for the Finance Department.

Our audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States, except for the completion of an external peer review of the Office of the Auditor General within the last three years.

### **Audit Objectives**

The overall audit objectives were:

- Determine whether one or more payments made to vendors were made for the same project or contract that exceeded \$25,000.
- Determine whether the Finance Department complied with the City's purchasing ordinance including obtaining City Council approval for vendor contracts in which one or more payments to a vendor for the same project exceeded \$25,000.

### **Audit Methodology**

To accomplish our audit objectives, we performed the following:

- Queried the Detroit Resource Management System to obtain all payments to vendors providing accounting related services.
- Interviewed staff from various divisions within the Finance Department.
- Reviewed selected vendor records for those vendors receiving checks within the audit period.
- Reviewed the City's purchasing policies and procedures.
- Reviewed the Internal Revenue Service reporting requirements.
- Performed other audit procedures, that we considered necessary to achieve our audit objectives.

## FINDINGS AND RECOMMENDATIONS

### **1. Create a Contract Purchase Order when Payments to a Vendor are Estimated to be \$25,000 or More**

The Finance Department (Department) circumvented purchasing procedures and its own internal control procedures when it paid invoices totaling \$225,684 to three vendors in calendar years 2005 and 2006. Our analysis of payments made to selected vendors disclosed the following:

1. The Department paid 22 invoices totaling \$166,554 to a single vendor without obtaining competitive bids, issuing a purchase order or professional services contract or obtaining the required approvals of the Purchasing Director, Budget Director or Deputy, Finance Director or Deputy, Corporation Counsel, and the City Council.

A Department representative approved the 22 invoices. Over one-half of the invoices were processed for payment using the quick check method to expedite the processing and issuance of the check. The Department further circumvented internal controls when it processed the payments for which the same employee both requested and approved the related check request.

2. The Department paid nine invoices totaling \$59,131 in excess of amounts authorized in two approved personal service contracts. The Department paid \$44,060.85 after the contracts expired. However, the Department did not obtain City Council approval to increase the personal service contracts amount or extend the contract period. Nor did the Department obtain purchase orders for five of the nine invoices paid.

Payments for services provided through a personal service contract are made through the payroll system. The payroll system is designed to prevent payments in excess of the authorized contract amount. However, prior to the contract expiration date the Department simultaneously processed payments through the payroll system and the accounts payable system. The Department processed invoices through the accounts payable system to issue payments in excess of the authorized personal service contract.

The City has established formal purchasing procedures that require:

- Competitive bidding to allow for the purchase of goods and services at fair and reasonable costs;
- The issuance of a professional service contract for the purchase of services that require advanced, specialized knowledge, expertise or training and require a formalized document approved by the Law Department;
- The Purchasing Director to sign all contracts;
- City Council to approve all professional service contracts; and
- The issuance of a purchase order for the purchase of services.

A Department representative stated that due to departmental staff reductions the Department had to obtain the outside services of a professional accounting firm in order to complete the preparation of the City's Comprehensive Annual Financial Report.

When the City Council is not provided an opportunity to review and approve the City's expenditures, as required by the purchasing ordinance, complete and proper oversight of public funds is lacking. Additionally, making payment for services performed without following City procedures negates preventative controls, increases the potential for fraud, increases the likelihood of evasion of the City income tax, and decreases opportunities for more efficient purchasing. Furthermore, the Department is responsible for establishing the internal controls to ensure that the City's assets are safeguarded and used in the most cost-effective manner. The Department sets the tone for the entire organization as to the importance and value placed on adhering to those controls.

**Recommendation**

We recommend that the Department follow all City procedures and ordinances related to the procurement of and payment for services. The Department should set an example for all City departments to follow.

## **2. Issue all Applicable Vendors Internal Revenue Service Form 1099**

The Finance Department Accounts Payable Division (Division) did not properly code the records in the Detroit Resource Management System (DRMS) for two vendors so that the Division could properly report the payment of nonemployee compensation in calendar year 2005. As a result, the Division did not prepare or mail the Internal Revenue Service (IRS) Form 1099 to the vendors or the IRS, nor were they able to detect that Form 1099 had not been prepared and mailed. These two vendors received \$11,856.08 and \$38,190.85 in 2005. As of February 28, 2006 the Division had not prepared and mailed Form 1099 to the vendors.

A Finance Department representative said that the Division did not send out as many Form 1099s as they should have. The DRMS allows for the input of vendor information and subsequent payment to vendors without the input of a tax identification number or the coding necessary to prompt the system to generate the Form 1099. This control weakness reduces the Department's ability to detect improper payments as well as compensation that should be reported.

IRS regulations require that payers furnish each payee a completed Form 1099 by January 31 of the year following receipt of compensation. The IRS has various penalties that may be imposed on an employer if Form 1099 is not furnished to the recipient by the due date. These penalties range from \$15 per information return, with a maximum of a \$75,000 penalty, and \$100 per payee statement (information return), with no maximum penalty.

### **Recommendations**

We recommend that the Finance Department establish procedures to ensure that all vendors are properly coded in DRMS so that they receive IRS Form 1099 by January 31. We also recommend that the Division conduct an analysis to identify any of the vendors that were not properly coded in DRMS. Finally, we recommend that the Division prepare and distribute the Form 1099 to the applicable vendors and the IRS.

### **3. Collect Overpayment Made to the Personal Service Contractor**

The Human Resources Department overpaid one personal service contractor \$1,062.50 in April 2005. Our analysis of payments made to the personal service contractor indicated that the Human Resources Department processed a payment to compensate the contractor for 80 hours worked during the pay period March 7, 2005 through March 20, 2005. However, the documentation submitted by the contractor report 67.5 hours worked during the period.

The Human Resources Department representatives indicated that checks are not processed without approved timesheets. Good internal controls require a verification process to ensure that hours entered for payment agree with the hours reported on the approved timesheet or invoice.

#### **Recommendations**

We recommend that the Human Resources Department pay personal service contractors for hours of service documented on approved timesheets or invoices. We also recommend that the Human Resources Department recover the overpayment of \$1,062.50 from the personal service contractor.





CITY OF DETROIT  
FINANCE DEPARTMENT

## ATTACHMENT A

COLEMAN A. YOUNG MUNICIPAL CENTER  
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DETROIT, MICHIGAN 48226  
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WWW.CI.DETROIT.MI.US

May 11, 2006

Mr. Loren E. Monroe, Auditor General  
Office of the Auditor General  
Coleman A. Young Municipal Center  
2 Woodward Avenue, Suite 208  
Detroit, Michigan 48226

Dear Mr. Monroe:

The following presents the Finance Department's response for the indicated finding and related recommendation in the March 2006 Audit of Contracts Less than \$25,000, as prepared by the Office of the Auditor General.

Finding No. 1 Create a Contract Purchase Order when Payments to a Vendor are Estimated to be \$25,000 or More

Department's Response:

The Finance Department concurs with the Auditor General's recommendation. In the future, the Finance Department will create a Contract Purchase Order when payments to a vendor are estimated to be \$25,000 or more. Hence, the Finance Department will follow all established purchasing procedures. All Finance Department Managers will be instructed via a memo that they must adhere to the City's purchasing procedures or they will be subject to disciplinary action.

Finding No. 2. Issue all Applicable Vendors Internal Revenue Service Form 1099

Department's Response:

The Finance Department concurs with the Auditor General's recommendation. The Finance Department will work with the Information Technology Department to ensure that all vendors are properly coded in DRMS so that they will receive IRS Form 1099 by January 31. The Finance Department will perform analysis to identify vendors that were not properly coded in DRMS. For such vendors, the Finance Department will distribute the Form 1099 to the applicable vendors and the IRS.

Sincerely,

Roger Short, Interim Chief Financial Officer

Attachments

F:\JenWork\Response to Auditor General on Contracts Less Than 25k

KWAME M. KILPATRICK, MAYOR



CITY OF DETROIT  
HUMAN RESOURCES DEPARTMENT  
EMPLOYEE SERVICES DIVISION

ATTACHMENT B

310 CAY Municipal Center  
PHONE (313) 224-3180  
FAX (313) 224-9434

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June 5, 2006

Mr. Loren E. Monroe, CPA  
Auditor General  
City of Detroit  
2 Woodward Ave., Room 208  
Detroit, Michigan 48226

Dear Mr. Monroe:

SUBJECT: HR Response to Provision #3 of Audit of Contracts less than \$25,000

I'd like to thank you for the opportunity to respond to the allegations set forth in your Audit of Contracts less than \$25,000, that pertain to the Human Resources Department. Please allow me to provide some historical information regarding the contract in question. First, Human Resources will only pay contractors based on an approved contract up to the maximum allowable hours/dollars associated with the contract.

In the case at issue, the contractor reached the maximum hours allowed under his contract on or about the first pay in February 2005. Human Resources did not process any payroll payments for the contractor until an amended contract was approved. The amended contract was approved on March 23, 2005 and the amended contract became active on the payroll system on April 2, 2005.

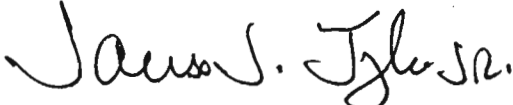
Despite the expiration of his contract, the contractor continued to work a total of three pay periods from February 2005 to April 2005. Human Resources did not pay the contractor after his original contract expired or before the amended contract was approved. Therefore, the contractor was owed retro payments for services rendered between February 2005 and April 2005. Once the amended contract was approved, Human Resources paid him for the three pay periods through two Gross Pay Adjustments ("GPA"). One GPA for straight time, and one GPA for overtime.

Based on my findings there was an overpayment error on the first GPA for 12.5 hours and we are currently in the process of recovering the overpayment. Please be assured that all payments were processed in accordance with timesheets. There was no advance check issued for the period in question. All of the rules regarding payment to contractors were strictly adhered to. Human Resources is striving to eliminate all payroll errors and I believe we will achieve this goal through the implementation of the new Human Resources Management System (payroll system).

Mr. Loren E. Monroe, CPA  
Auditor General  
June 5, 2006  
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Please feel free to contact me with any additional questions you may have. Again, thank you for the opportunity to respond to the Audit.

Respectfully,

A handwritten signature in cursive script, reading "James J. Tyler, Jr.", written in black ink.

James J. Tyler, Jr., Director  
Human Resources Department

JJT/KDH/cms

cc: Ms. Patricia A. Peoples, Deputy Director  
Human Resources Department

Ms. Kimberly D. Hall, General Manager  
Human Resources Department